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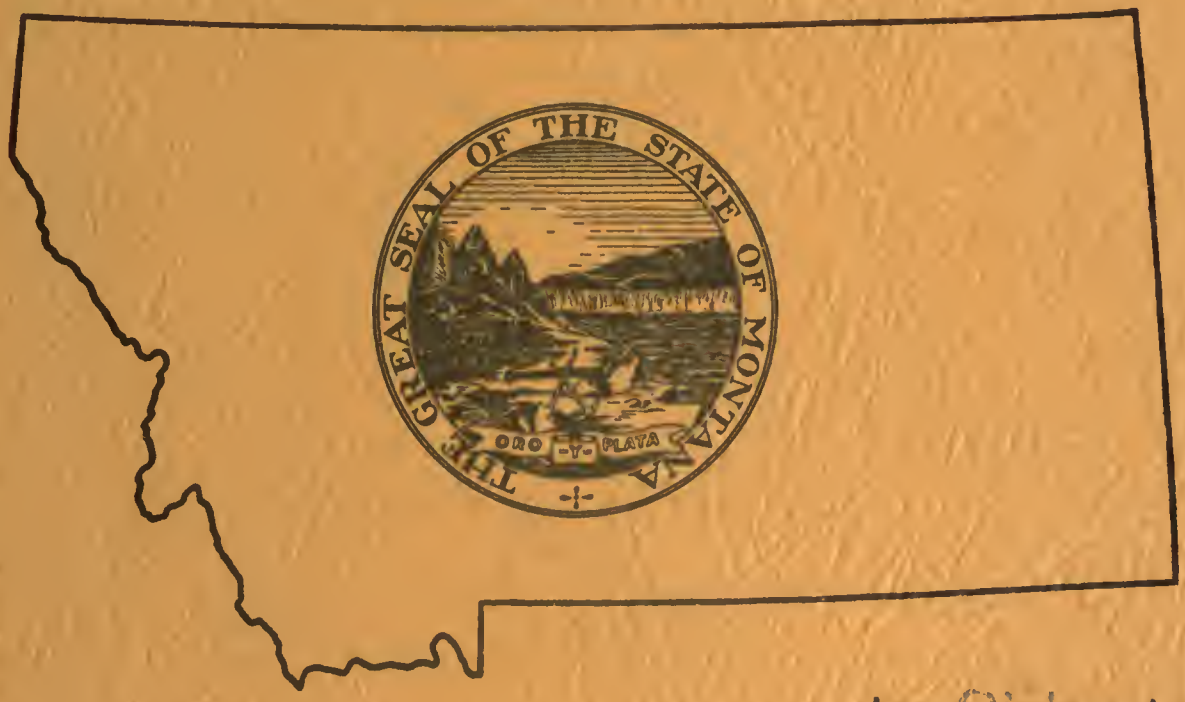
Self-Insurance on State-Owned Property



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SELF-INSURANCE

ON

STATE-OWNED PROPERTY

A REPORT TO THE FORTY-SECOND

LEGISLATIVE ASSEMBLY

by the

MONTANA LEGISLATIVE COUNCIL

December 1970

Report No. 30

To Members of the Forty-Second Legislative Assembly:

Senate Joint Resolution No. 26 directed an examination of the feasibility and/or desirability of establishing a self-insurance fund for state-owned properties. Such a concept has been often studied by public bodies, corporations, and even individuals. The wealth of the entity seems to have been the key as to whether or not it assumed a portion of its risk.

An entity with no insurance is known as a "self-assumer" -- an obvious risky undertaking by a political body which by its nature is sensitive to criticism should an uninsured loss occur making substantial demands on a possible shaky budget.

However, there is merit in assuming a deductible amount providing that the loss frequency is not too great. The subcommittee has made an in-depth study of the problem and the Council submits the attached for your consideration. We must bear in mind too that because of the civil unrest in the nation today, many, many public entities are finding that the only way they can purchase property insurance is with a very large deductible amount.

Respectfully submitted,

SENATOR FRANK W. HAZELBAKER
Chairman
Legislative Council

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1969 - 1970

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SENATE JOINT RESOLUTION NO. 26

A JOINT RESOLUTION OF THE SENATE AND HOUSE OF REPRESENTATIVES ASKING THAT THE LEGISLATIVE COUNCIL CONDUCT A STUDY OF THE FEASIBILITY AND DESIRABILITY OF ESTABLISHING A SELF-INSURANCE FUND FOR STATE-OWNED PROPERTY.

WHEREAS, at the present time the state of Montana expends more than four hundred thousand dollars ($400,000) for insurance on state-owned property each biennium, or approximately two hundred thousand dollars ($200,000) each year, and

WHEREAS, over the past eleven (11) years actual losses of state-owned property have averaged substantially less than the insurance premium, and

WHEREAS, some states have established a self-insurance fund for state-owned property which has resulted in substantial savings in those states, and

WHEREAS, it might be both feasible and desirable for the state of Montana to establish a self-insurance fund.

NOW, THEREFORE, BE IT RESOLVED BY THE SENATE AND HOUSE OF REPRESENTATIVES OF THE STATE OF MONTANA:

That the Legislative Council is requested to conduct a study of the feasibility and desirability of establishing a self-insurance fund for state-owned property.

BE IT FURTHER RESOLVED, that the Legislative Council is requested to report its findings, together with recommendations and any necessary implementing legislation, to the Forty-Second Legislative Assembly.

BE IT FURTHER RESOLVED, that the Secretary of State is instructed to send a copy of this resolution to the Legislative Council.

CHAPTER I

INTRODUCTION

The Legislative Council has been requested to make a study of the feasibility and desirability of establishing a self-insurance fund for state-owned property, under Senate Joint Resolution No. 26. A report of findings, recommendations and necessary implementing legislation is also required.

The Subcommittee discussed the study on self-insurance with Dr. Patricia Douglas, Bureau of Business and Economic Research, University of Montana. A proposal to make the study was reviewed and approved by the Subcommittee and subsequently by the Council. The research proposal showed an examination of the question of whether or not a self-insurance program should be applied to state-owned properties. A number of states and political subdivisions have researched this subject, but it has not been done in Montana.

The experience of other states has been analyzed, including a review of the statistical base upon which their decisions were made. Next, the summary findings were reviewed by an expert on self-insurance for appraisal and recommendations, in view of Montana's requirements, and, finally, the material was presented in a report to the Council at a cost of $1,190.78 ($445.22 less than was allotted for the study).

Dr. Patricia Douglas was responsible for the study; the supervisor of the study was Laurel Pease, Professor of Insurance, University of Montana, and the graduate student who was responsible for the research was Mr. Willard Michels. The expert who reviewed the study was Dr. Goshay of the University of California.

Material has been gathered from state agencies, insurance associations and private researchers. The four major areas of concern are: (1) financial capacity of the state, (2) actual properties of the state as to where located, values, concentration, loss experience, etc., (3) political ramifications, and (4) administrative procedures and handling of funds.

Savings is not the answer to self-insurance. Private companies can weigh priorities, but the political process is required to weigh priorities in the state government. The best way to look at self-insurance appears to be on the basis of return. There are no acceptable across-the-board standards which can be utilized.

Another factor that is not resolved in self-insurance is judging the quantitative value as to what a loss may be. The question of how the public will react to a particular loss cannot be determined. State funds are required to replace properties which are destroyed and not covered by insurance -- the reaction of the citizens can be abrupt in such cases.

Losses due to campus disorders and social trends are not defined in the report as such but will probably be evident in the results shown.

Discussions covered catastrophe losses such as earthquake which could be very extensive -- such losses are normally not insurable. However, fire loss which may result from an earthquake is covered to the extent of the fire loss only after deducting the earthquake portion of the loss.

Discussions were held on the matter of claims, states that at one time had self-insurance and later dropped it, and other insurance matters. This study does not go into insurance other than property insurance.

CHAPTER II

THE NATURE OF INSURANCE AND SELF-INSURANCE

General

Self-insurance -- the concept of retaining risks -- has long been of interest to corporate risk managers, insurance companies, legislators and local administrators. The earliest form of a state insurance fund in the United States was the bank guaranty plan adopted in New York in 1829 for the payment of debts of insolvent banks. Throughout the years various states have examined and some have instituted self-insurance programs covering workmen's compensation, pensions, public property and many other types of exposures. However, the majority of programs actually instituted were for the purpose of covering workmen's compensation or public property; currently, there are nine states which maintain a self-insurance program for state and/or local property. Fourteen other states retain their own risks; that is, they do not utilize commercial insurance, but as will be demonstrated later, they do not meet the tests necessary for self-insurance, and are here referred to as self-assuming states. In addition, many local governments, especially school districts, have developed their own self-insurance programs, again primarily in the area of property coverage.

Many large corporations also maintain self-insurance programs covering fire, liability and/or workmen's compensation exposures. Of the 1,100 business firms with membership in the American Society of Insurance Management in 1960, 650 reported that they self-insured these exposures either wholly or in part through the use of large deductibles.

For a short period of time Montana was among those states which self-insured state-owned buildings and their contents. Although that program was abandoned by a public referendum, there has been continued interest in the savings possible through self-insurance. During the last legislative session the Senate and House of Representatives passed a joint resolution "asking that the Legislative Council conduct a study of the feasibility and desirability of establishing a self-insurance fund for state-owned property."

The purpose of this report is to provide the Legislative Assembly with some information necessary to examine the desirability and feasibility of a self-insurance program. Following a general review of the nature of self-insurance and its implications for governmental use, the self-insurance plans operated by other states will be examined. The primary purpose in examining these plans is to determine whether or not there are similarities among these states or their programs which may contribute to the success or failure of a self-insurance program. The third section will discuss Montana's past and present insurance program, along with an analysis of other characteristics which pertain to the implementation of a self-insurance program.

The Foundations of Self-Insurance

Self-insurance is often erroneously contrasted with insurance and, on that basis, dismissed as an alternative to commercial insurance. Insurance, in turn, needs -- but defies -- quick definition because it can be perceived differently through the eyes of an attorney, a social scientist, a mathematician or someone else. Most authors agree, however, that before insurance exists there must be an accumulation of funds and a transfer of risk. Since insurance is generally considered as one method of treating risk, then risk must also be defined. A special committee of the American Risk and Insurance Association noted that risk is "uncertainty as to the outcome of an event when two or more possibilities exist." Thus, risk exists only when the outcome of an event is unknown; for example, if we know that Montana's capitol building will not be destroyed by fire in 1970, there is no risk connected with this event. Seldom, if ever, can such an event be predicted. Not only are we unable to know with certainty whether or not damage will occur, but we

are unable to predict the extent of the loss. As one author notes:

> Most commonly..."risk" denotes a combination of hazards which are capable of causing loss or gain. When measured by probability, risk is considered the statistical expression of "chance" of loss or gain....From this view, the essence of risk is its variability.

If one accepts this concept of risk, the question then becomes how an individual, a business enterprise, or a governmental unit handles potential risks. The alternative ways of handling risks, or treatments of risks, as they are commonly referred to, have been grouped together in many different categories, but few of these different categorizations are mutually exclusive. This report will discuss the three most relevant alternative methods of treating risks: to transfer them, to prevent them, or to retain them. These three methods "simultaneously classify what is being done to the risk as well as to the economic consequences of the risk."

Transfer of risk has been described as the essence of insurance. If a property holder cannot afford to bear the potential loss associated with a risk, he treats that risk by transferring it to another party. The recipient, the insurer, accepts the transfer for a consideration, normally called a premium. "Prevention (of risk)...includes all activities for the purpose of (1) eliminating or reducing...loss...and (2) minimizing the loss that occurs...." Prevention, then, combines two traditional classifications of risk treatment, reduction and elimination.

Retention of risk, the method of primary importance in this report, occurs when an individual, a business enterprise, or a government entity decides for one reason or another to bear the burden of the possible loss associated with the risk. Thus, "retention is simply a result when the risk is not transferred or prevented. Whether or not the retention occurred consciously or unconsciously is irrelevant; the result is still retention." As such, both the classic example of "no-insurance" and "self-insurance" are types of risk retention.

A Conceptual Basis for Self-Insurance

Insurance literature does not adequately treat the definition and criteria of self-insurance. As long as the various authors discuss general criteria, they agree, in part on what constitutes self-insurance; however, there is little agreement regarding the specifics. For example, one author lists eight conditions that must be met before a program can be classified as one of self-insurance, while another discusses only three general requirements. Still another authority splits the difference with five major prerequisites. Despite this problem, it is possible to develop appropriate criteria which encompass these individual definitions by relying on three general works and one study concerned with self-insurance as it relates to private enterprise.

Generally speaking, the criteria for self-insurance are the same as those for a sound insurance program: adequate distribution of risks, financial capacity, conscious assumption of risk, catastrophe protection and competent management.

Self-insurance presumes that losses will occur and these losses must be, to a certain extent, predictable and hence relatively stable each year. No specific criterion for stability has been established for governmental programs, but for industrial firms, one authority maintains that "the exposure distribution of the firm should be broad enough to permit loss prediction, given an exposure base adjusted for changing conditions within, say, a 15 percent range over three or more fiscal periods."

The financial capacity criterion is met by establishing a reserve fund from which losses are paid. (Although cash flow and working capital capabilities

are sometimes used as measures of financial capacity for industrial firms, such measures do not seem applicable to governmental programs.) This is a particularly important criterion from a governmental standpoint; without such a fund, it might be necessary to float a bond issue each time public property was destroyed. Floating a bond issue may take months, and, as a result, valuable public services may be unavailable during the interim.

When the governmental unit predetermines the nature of its loss exposure and establishes a fund for the purpose of paying losses arising from those exposures, it has consciously decided to retain certain risks, another prerequisite for self-insurance. It should be noted that the mere cancellation of commercial insurance policies does not constitute self-insurance but rather "no-insurance." Under a no-insurance program losses are left to chance and treated as current expenses.

Clearly, most governmental units are not financially capable of absorbing all possible losses: for example, the state fund would not be in a position to afford the entire loss of the buildings surrounding the capitol if, say, an earthquake demolished most of these buildings. Therefore, catastrophe insurance must be purchased to cover such losses as a matter of course, just as an insurance company purchases reinsurance on some of its more substantial risks.

Insurance companies ordinarily provide a number of incidental services in the form of engineering and prevention measures which must be assumed by the self-insurer if the self-insurance program is to be operated effectively. Also, a self-insurance plan must include proper coverages for the exposure units and adequate loss reporting and collection procedures. Someone, for example, must determine how much each particular unit is worth, and once the claim is rendered, process the necessary paper work to verify the claim and to make the payment. All of these services require competent management.

Thus, in terms of a definition, self-insurance is a conscious plan of risk retention which involves the establishment of a reserve fund for losses. The number of exposure units has been examined and determined to be adequately distributed in a particular geographic area, and a maximum level of risk assumption has been set within the financial capacity of a governmental unit. Further, a self-insurance program must also include engineering and prevention measures, competent management, adequate allowance for catastrophe losses and proper coverages and loss procedures.

This definition helps to clarify a common misunderstanding about self-insurance: it is not the same as no-insurance. Ironically, the primary distinction between the two is the extent to which commercial coverage is used. There is no commercial coverage with a program of no-insurance; a businessman or governmental unit qualifies simply by cancelling all insurance contracts and charging losses to current expense. A self-insurer, on the other hand, retains commercial coverage for the large catastrophic losses and establishes a fund from which to pay those losses not included in the commercial contract.

A Realistic Look at Self-Insurance

Although the preceding definition of self-insurance provides a conceptual framework for discussion, it does not provide an adequate basis for examining the traditional and more realistic issues. For example, a governmental unit could establish a risk-assumption level which required little commercial insurance and still operate within the definitional parameters noted above, as long as there were sufficient reserves, some catastrophic protection, or the like. Few would argue, however, that this is an appropriate base on which to launch a self-insurance program in a state like Montana: it takes years to build up the kind of reserves required by such a program; administrative procedures are not developed quickly even though they may be easily defined; and constraints on such things as investment of the fund's assets are relevant only if the size of the fund warrants such expenditures ("securing

competent management," for instance, has different connotations for a fund of $50,000 than it would have for a $500,000 fund).

Presuming some program which is less than that of total self-insurance, one of the relevant questions is: What are the costs and savings associated with a self-insurance program? Obviously, one cannot examine specific costs or savings without referring to a specific program; nevertheless, it is possible to discuss general areas of expected savings and costs. The actual costs or savings associated with self-insurance are ultimately determined by comparing the expenses incurred by insurance companies with those of a state-operated self-insurance fund. Approximate expense ratios of property-casualty companies can be used for purposes of demonstration:

Components of Insurance Premium
Expressed as a Percentage of Premium Dollar

Tax expense	2.7
Loss adjustment expense	4.8
Acquisition expense	27.1
General expense	8.2
Profit and contingency expense	6.5
Total expense (loading)	49.3
Direct losses	50.7
Total	100.0

A state self-insurance program could eliminate that portion of the premium dollar which goes to pay taxes -- offset, of course, by the loss of the premium tax revenue related to the insurance of state-owned properties. Also, a self-insurance program would save a large portion of the acquisition expense, particularly those parts going for commissions or those general expenses which go for any kind of bureau membership or home office maintenance, and that part of the profit and contingency expense which is profit to an insurance company. A more detailed breakdown of these expenses indicates than on average 20.9 percent of every premium dollar represents commissions and only 3.6 percent of the profit and contingency factor represents average industry profits. In addition, about .4 and 1.1 percent of each premium dollar is typically spent for bureau membership and home office maintenance respectively. These items may be used as an initial estimate of the potential savings for a state self-insurance program. In total, they represent 26.0 percent (.4 + 1.1 + 20.9 + 3.6 = 26.0) of the total premium; thus presuming a total premium of $300,000, a state might expect to save $78,000 per year with a self-insurance program. (This initial estimate also assumes that any tax savings from such a program would probably be totally offset by premium tax revenue foregone; this appears to be a realistic assumption in Montana.)

From here on, the possible costs or savings are very difficult to estimate because the extent to which the remaining items become plus or minus factors depends upon the type of program and the efficiency with which it is operated. The question of efficiency is a nebulous one, but members of the insurance industry have long argued that costs will not decline with a state fund because: (1) pressure from insurance companies for loss prevention would be removed and therefore losses and loss adjustment costs would rise; (2) no single state would have a fund large enough to realize economies of management -- either in investing the funds or in handling the claims; and (3) legislators and administrators are likely to neglect the administrative facets so the entire program will be inefficiently managed. Obviously, there are isolated instances which support each allegation, but it is not apparent that these arguments are necessarily accurate in general. Regarding the argument for declining loss prevention efforts, budgetary units (state agencies, etc.) might assume more responsibility for effective loss prevention standards under a self-insurance than under a commercial program. If losses and premiums were paid from the budgets of individual units, they would probably be more aware of, and therefore more responsive to, premium and loss changes. In addition,

insurance companies are not likely to completely disregard loss prevention efforts if they still carry the catastrophic risks on these same properties.

To what extent administrative costs would change with a self-insurance program is not determined solely by the size of the fund. That is, the "economies of scale" argument is relevant only where commercial insurance implies that all administrative costs are borne by the respective insurance companies. If some administrative responsibility is assumed by the state with a commercial insurance program, the additional costs to assume all responsibilities may be minimal; this is particularly true when insurance company and state functions are duplicative. Since a number of groups, including several state agencies, generally share the responsibility for fire inspection, prevention and loss procedures, it is by no means self-evident that total administrative costs would rise with self-insurance -- unless, of course, one maintains that all governmental activities are, by their very nature, inefficient. This latter argument does not change the problem. Instead it merely points out that there is no reason that government, in pursuit of the goals of private enterprise, must always make decisions on an uneconomical basis!

The question of whether or not legislators and administrators are likely to neglect the administrative facets is also difficult to answer. There is no doubt but what any self-insurance plan requires careful administration; someone must be charged with paying claims, inspecting exposures, preventing losses, keeping the necessary records, and performing the many other duties connected with any insurance program. To hazard a guess as to the seriousness with which these duties would be performed seems almost ludicrous. The answer, in large part, depends upon the importance of the self-insurance decision as compared to all the other decisions faced by legislators and administrators -- that is, the priority of the self-insurance decision. Unfortunately, unlike private enterprise, government has no systematic basis like payback, rate of return, etc., upon which to establish priorities. Thus, one is left with some qualitative factors; quite apart from the feasibility of self-insurance, legislatures have tended to assign a high priority to programs which are eligible for federal matching. No federal funds would be available for a self-insurance program. On the other hand if legislators foresee a time when it may be impossible to purchase commercial insurance for state buildings (especially those which are educational or penal in nature), then the self-insurance decision would have a high priority, even without matching funds, and accordingly, it is unlikely that the administrative facets of the program would be neglected.

As another qualitative judgment, if legislators expect a self-insurance decision to materially affect their long-standing association with commercial carriers, the majority may have a vested interest in seeing the program fail. In this case, there may be less insistence on a conscientious performance of the insurance tasks. In short, the burden of proof rests with those making the decision.

One other argument is frequently raised in a discussion of self-insurance: self-insurance constitutes an invasion of a field of private enterprise and is contrary to established public policy. In refutation, others maintain that self-insurance is not a violation of private enterprise since insurance principles are based on the assumption that property owners need protection against hazards which they cannot afford to bear. Thus, self-insuring losses which the governmental entity can afford and purchasing insurance for catastrophe coverage are quite consistent with basic principles of insurance and public policy.

The aforementioned arguments must be seriously evaluated. However, they are difficult to evaluate conclusively without reference to a particular program. Many of these arguments can be examined practically by reviewing the experiences in states which operate self-insurance programs.

CHAPTER III

STATE SELF-INSURANCE PROGRAMS

General Nature of the Programs

Of the twenty states which have had a self-insurance program for state property at one time or another, nine still self-insure state-owned, and in some cases local, properties. Those nine states are: Alabama, Florida, Georgia, Kentucky, North Carolina, North Dakota, Oregon, South Carolina, and Wisconsin. The operations in these states fully comply with the self-insurance definition and prerequisites outlined in Chapter II. Fourteen other states retain certain risks -- ranging from liability and property damage to pension funds -- but they have no funded program and are therefore not classified as self-insurers in this report.

With the exception of Georgia's, these self-insurance programs have all been in existence for twenty-five years or more. South Carolina's program was begun in 1900 and Wisconsin's in 1903. Administrative responsibility resides with the Insurance Commission in four states; administering agencies in the other states include the departments of finance, general services, purchases, commerce and the treasury. The administering agency is typically responsible for fulfilling the statutory requirements such as investing the funds and reporting the results of operation to the governor and/or legislature. However, most agencies have hired a professional fund manager to implement and direct the program.

Self-Insurance Coverage

All nine state self-insurance programs cover the perils of fire and those included within the commercial definition of "extended coverage," i.e., windstorm and hail, explosion, riot and civil commotion, aircraft and vehicular damage, and smoke. In addition, some states carry vandalism and malicious mischief, boiler explosion and sprinkler coverage.

Universally, all state properties and their contents are included under the self-insurance programs, and in five states, county and/or local governmental units and/or school districts are covered. In some cases the county, local or school units have the option of state or commercial insurance. One state, Oregon, also insures vessels used in providing ferry services or in the university oceanographic research.

Regardless of which properties are covered, their values must be determined, both for self-insurance and reinsurance purposes. The state laws are frequently vague in specifying the determination of insurable values. There is no prescribed basis in North Carolina, and in North Dakota insurable values are determined by the insurance commissioner or an appraisal company. Florida and Oregon use replacement cost and Kentucky uses replacement cost less depreciation to determine values. Three states -- Alabama, Georgia and Wisconsin -- refer to "actual values," and South Carolina's law specifies actual cost. The dollar amount of coverage is then determined by applying a flat percentage to these insurable values, usually from 50 to 90 percent.

Although the basis for setting insurance values and coverages varies among the states, each state has established maximum risk levels to be assumed under the self-insurance program. That is, all nine states have the authority to purchase reinsurance and all have current contracts. There are, however, a variety of contractual arrangements. North Dakota and South Carolina use an excess per-occurrence form; Florida and North Carolina use an excess per-building and per-loss form; Alabama, Georgia and Kentucky have per-item and per-occurrence combinations; Wisconsin and Oregon employ an excess of cumulative yearly-loss type. Since property values, coverages and reinsurance agreements vary among the states, the dollar limit of risk assumed also varies. For example, in Florida all risks above $50,000 are reinsured, while North

Carolina reinsures only those risks whose value exceeds $500,000. About half the states place reinsurance by competitive bids; the other states negotiate the prices and terms of the reinsurance contracts.

Since these self-insurance programs provide specific coverage to individual agencies, premium rates must be set, just as under a commercial program. With the exception of North Carolina and Oregon, premium rates represent some proportion of commercial or rating-bureau rates. There is, however, no unanimity among the states concerning the exact proportion.

Operating Procedures

As was noted, each state has designated an administering agency for the self-insurance program. Although the agency's services, as prescribed by statute or executive decree, differ among the states, all seem very comprehensive when compared to those of commercial insurers. Generally, each state has well-defined administrative procedures for handling: (1) losses and claims; (2) investment assets and income; (3) accounting and reporting; (4) loss prevention and inspection; (5) reinsurance; (6) changes in property valuations; and (7) major disputes.

Summary data covering various aspects of these programs are presented in Table I, Parts 1 and 2. These data reveal the important differences and similarities among the programs. Of more importance, however, are the unique operating features which should be evaluated by any state considering a self-insurance program. The following summary presents some of the more innovative operating characteristics found in the nine states.

Losses and claims. In Oregon, claims are not paid until restoration (either repair or replacement) is completed, allowing both allotted and unallotted funds to be invested longer than they ordinarily would.

State agencies in Oregon and Kentucky have some control over the replacement of destroyed properties. In Oregon, with the approval of the state administrator, an agency can purchase or rebuild property which is similar but not necessarily identical to that which was destroyed. In Kentucky, the agency could even rebuild in a new location.

Coverages. South Carolina's administering agency can cancel the self-insurance coverage on any state-owned property that it considers uninsurable, provided ten-day notice is given to the state agency responsible for the property.

In Florida, buildings whose values are less than $500.00 are not insured, nor are contents which, in total, represent less than $500.00 in value. Losses on such properties must be replaced or repaired by the agency using the property.

The bond indentures covering state buildings which are financed by revenue bonds usually require commercial insurance. However, in Florida the authorizing resolution is generally written so that 50 percent of the coverage is provided by the state and 50 percent by a commercial carrier.

Several administrators supply each state agency, or department, school district or local government with an insurance policy which shows the state's assumption of liability, item by item. Sometimes the amount of reinsurance obtained on each item is also shown.

Premium charges. Most of the states can deviate from their own standard premium rates. In Oregon, for example, additional assessments can be made for extraordinary hazards. And in South Carolina when the fund balance exceeds 5 percent of the total insurance in force, premiums are reduced. The reverse is true in North Dakota; premium rates charged by the fund cannot exceed 60 percent of bureau rates unless insurance reserves decline below $3 million.

TABLE I - Part 1

State Self-Insurance Programs,
Various States

State	Year Initiated	Administering Agency or Department	Property Covered (other than state)	Perils Covered (other than fire and extended coverage)	Basis of Insurable Values
Alabama	1923	Finance	Public schools	Vandalism & malicious mischief	Actual
Florida	1917	Treasury	None	None	Replacement
Georgia	1965	Purchases	None	Vandalism & malicious mischief	Actual
Kentucky	1936	Insurance	None	None	Depreciated replacement
North Carolina	1945	Insurance	Local government	Vandalism & malicious mischief Sprinkler & business interruption	Not available
North Dakota	1919	Insurance	Local government, townships & schools	Vandalism & malicious mischief	Not available
Oregon	1925	Commerce	Vessels	Vandalism & malicious mischief Storm, flood, earthquake	Replacement
South Carolina	1900	General services	County property & public schools	Vandalism & malicious mischief	Actual
Wisconsin	1903	Insurance	County, city, town & school districts	Vandalism & malicious mischief (named exclusions)	Actual

TABLE I - Part 2

State Self-Insurance Programs,
Various States

State	Fund Limit	Basis for Reinsurance	Placement of Reinsurance	Allowable Investments[a]	Reinsurance Coverage
Alabama	None	Per item & per occurrence	Negotiation	US, state & local bonds	No single amount
Florida	None	Per loss & per building	Negotiation	US & local bonds	Risks over $50,000
Georgia	None	Per item & per occurrence	Bidding	Time deposits	90% over $25,000 100% over $250,000
Kentucky	$2 mil.	Per item & per occurrence	Negotiation	US, state & local bonds	$300,000
North Carolina	None	Per loss & per building	Negotiation	US securities	$500,000
North Dakota	$12 mil.	Per occurrence	Bidding	US, state, local & corporate bonds	$500,000
Oregon	2% of insured value	Cumulative	Bidding	US securities	$200,000 & cumulative over $1.75 mil.
South Carolina	5% of insurance in force	Per occurrence	Bidding	US securities & loans to state & local governments	$150,000 per occurrence
Wisconsin	$2 mil.	Cumulative	Bidding	Full range	Annual or single loss over $2 mil.

[a] State and local refer to bonds of the self-insuring state.

Loss prevention and inspection. The laws of several states give the administering agency the authority to regularly inspect state properties. In some cases the administrator can force a state agency or local board to repair hazardous risks out of its own budget and to adopt additional loss prevention measures.

Three states -- Florida, Kentucky and South Carolina -- have been particularly imaginative in developing loss prevention incentives. When the reserves in these states exceed a certain limit, the excess can be invested in improvements capable of effecting loss control. Among this group, the most developed system is found in South Carolina; over $13 million is currently invested in sprinkler loans to insured agencies.

Fund investments. Investment of accumulated reserves tends to assume diverse forms, principally because of the varying statutory limitations on permissible risk assumption. Generally there is a concentration on government securities. It is noteworthy then that Florida and Wisconsin allow a full range of investments through corporate securities -- including common stock. North Dakota is contemplating similar legislation.

Arbitration. At least six of the nine states have established procedures for settling major disputes. With the exception of Florida, where the Board of Commissioners solves disagreements, it is common to have the two parties to the dispute each appoint one arbitrator, who, in turn, select a third member.

Operating Performance

The nine self-insurance states represent a broad cross-section of the United States, in terms of economic and demographic characteristics. Located in the west, midwest and southeast, these states have populations ranging from 639,000 to over 4.5 million and 1967 per capita income from $2,163 to $3,156. Some are predominantly agricultural states while others are heavily oriented toward manufacturing and trade. Insured property values reflect the divergence in population and income: North Dakota had self-insured property of $305 million in 1968 while Wisconsin had property values of nearly $2 billion. Assets controlled by the various funds also represent a wide spectrum -- from $241,000 to over $26 million. There is, however, a concentration of asset values around the $2-$4 million level -- in some cases because of the statutory limitations on asset accumulation.

This diversity seems to have very little effect on the operating results of the programs (Table II). That is, there is no apparent correlation between the economic or demographic data or the absolute size of the program and the operating results. For example, despite differences in the size of the funds and investment regulations, all states have earned about 3.5 percent on their average assets; only North Dakota, Oregon, and Georgia have consistently earned more than 4 percent.

Although investment earnings are a significant measure of performance, a self-insurance program must ultimately be evaluated on its loss and expense experience. These statistics are presented in Table II. Comparing the ratios (losses and expenses as a percentage of premiums) to those of commercial carriers is complicated by the fact that aggregate data for commercial companies are based on premiums earned; most states, on the other hand, report on a premium-written basis. Also, most insurance reports are on a calendar-year basis while state reports typically cover fiscal periods. For both reasons, a nine-year period was considered necessary to evaluate the data properly.

Loss ratios (losses as a percentage of premiums) vary among the states, just as they do among insurance companies. However, as Chart I shows, the average for eight self-insuring states is consistently less than that for stock and mutual companies who write fire and extended coverage. Since the commercial average represents hundreds of companies while the self-insurance average

TABLE II

Operating Statistics
Nine State Self-Insurance Funds
1960-1968

	Alabama[a]					Florida[d]				
Year	Total Property Value ($000,000)	Fund Assets ($000)	Loss Ratio[b] (%)	Expense Ratio[c] (%)	Return on Avg. Assets (%)	Insurance in Force ($000,000)	Fund Assets ($000)	Loss Ratio[b] (%)	Expense Ratio[c] (%)	Return on Avg. Assets (%)
1960	372	5,169	48.7	6.4	NA*	219	4,986	NA	8.5	NA
1961	397	5,636	34.2	5.8	3.5	238	5,201	NA	9.9	3.3
1962	453	6,149	50.2	4.9	3.6	275	5,548	7.0	10.1	3.3
1963	484	6,782	16.7	5.6	3.5	295	5,880	11.4	9.6	3.2
1964	519	7,160	54.5	7.7	3.6	326	6,171	33.3	11.0	3.2
1965	552	7,788	26.5	7.1	3.7	364	6,431	57.1	13.4	3.1
1966	606	8,241	63.3	7.3	4.3	397	6,749	36.0	9.4	3.1
1967	667	9,190	30.5	7.4	4.0	408[e]	7,187	9.7	10.8	3.0
1968	727	8,867	65.9	8.2	4.3	422	7,688	12.4	9.8	3.0

* NA denotes not available.
a Data are for fiscal year ending September 30.
b Losses as a percentage of premiums.
c Expenses as a percentage of premiums.
d Data are for fiscal year ending June 30.
e Estimated.

TABLE II (continued)

Year	Kentucky[a] Insurance in Force ($000,000)	Fund Assets[f] ($000)	Loss Ratio[b] (%)	Expense Ratio[g] (%)	Return on Avg. Assets (%)	North Carolina[a] Total Property Value ($000,000)	Fund Assets ($000)	Loss Ratio[b] (%)	Expense Ratio[h] (%)	Return on Avg. Assets (%)
1961	225	2,192	26.5	10.0	NA	450	2,464	10.5	30.8	NA
1962	245	2,359	22.4	10.0	3.0	475	2,646	5.0	29.0	3.2
1963	270	2,399	25.9	30.9	2.5	521	2,916	62.0	30.2	3.5
1964	300	2,389	29.5	30.3	2.8	535	3,175	29.2	28.4	3.5
1965	342	2,456	7.6	39.7	2.7	558	3,308	68.2	25.3	3.5
1966	365	2,475	27.0	31.4	2.8	584	3,439	65.6	30.6	3.7
1967	370	2,553	11.7	28.5	2.6	636	3,744	39.0	18.4	4.2
1968	395	2,670	5.0	10.0	2.4	702	4,040	50.9	30.1	4.0
1969	450	2,190	57.0	10.1	3.9	781	4,200	66.6	31.5	4.3

f Amount that would have accumulated in the fund without transfers to capital construction program.
g The expense ratio (expenses as a percentage of premiums) for 1963-1967 includes the cost of reinsurance.
h The expense ratio (expenses as a percentage of premiums) includes the cost of reinsurance.

TABLE II (continued)

Year	South Carolina[a] Insurance in Force ($000,000)	Fund Assets ($000)	Loss Ratio[b] (%)	Expense Ratio[h] (%)	Return on Avg. Assets (%)	Wisconsin[i] Insurance in Force ($000,000)	Fund Assets ($000)	Loss Ratio[b] (%)	Expense Ratio[c] (%)	Return on Avg. Assets (%)
1960	501	14,483	29.3	28.7	NA	754	7,554	35.5	7.2	NA
1961	543	15,917	14.3	29.3	2.7	884	8,101	23.1	9.2	3.1
1962	585	17,157	29.0	21.0	3.4	995	8,558	63.1	10.8	3.6
1963	623	18,689	9.5	21.0	2.9	1,186	8,963	64.2	14.1	4.1
1964	670	20,119	25.2	21.4	3.7	1,278	5,738	87.1	13.8	3.9
1965	711	21,558	44.2	22.8	3.5	1,450	5,510	154.4	13.8	3.7
1966	782	22,591	51.3	23.8	3.6	1,652	4,765	47.9	13.4	4.1
1967	892	24,050	41.0	26.7	3.8	1,765	5,950	70.3	12.7	4.2
1968	1,018	25,773	46.1	24.0	4.1	1,987	3,159	94.4	13.5	---[j]

[i] Data are for calendar year ending December 31.
[j] Negative amount.

TABLE II (continued)

North Dakota[k]

Year	Total Property Value ($000,000)	Fund Assets ($000)	Loss Ratio[b] (%)	Expense Ratio[n] (%)	Return on Avg. Assets (%)
1960	234	4,696	51.7	12.5	NA
1962	292	5,529	34.6	11.7	4.9
1964	316	6,502	41.6	9.6	5.1
1966	343	7,545	27.4	6.8	5.6
1968	305	7,944	100.5	29.8	8.2

Oregon[l]

Total Property value[m] ($000,000)	Fund Assets ($000)	Loss Ratio[b] (%)	Expense Ratio[c] (%)	Return on Avg. Assets (%)
301	2,956	NA	NA	NA
352	2,970	NA	NA	7.4
440	1,932	680	7.0	8.8
513	2,032	174	3.8	10.4
602	241	447	2.5	16.2

Georgia[n]

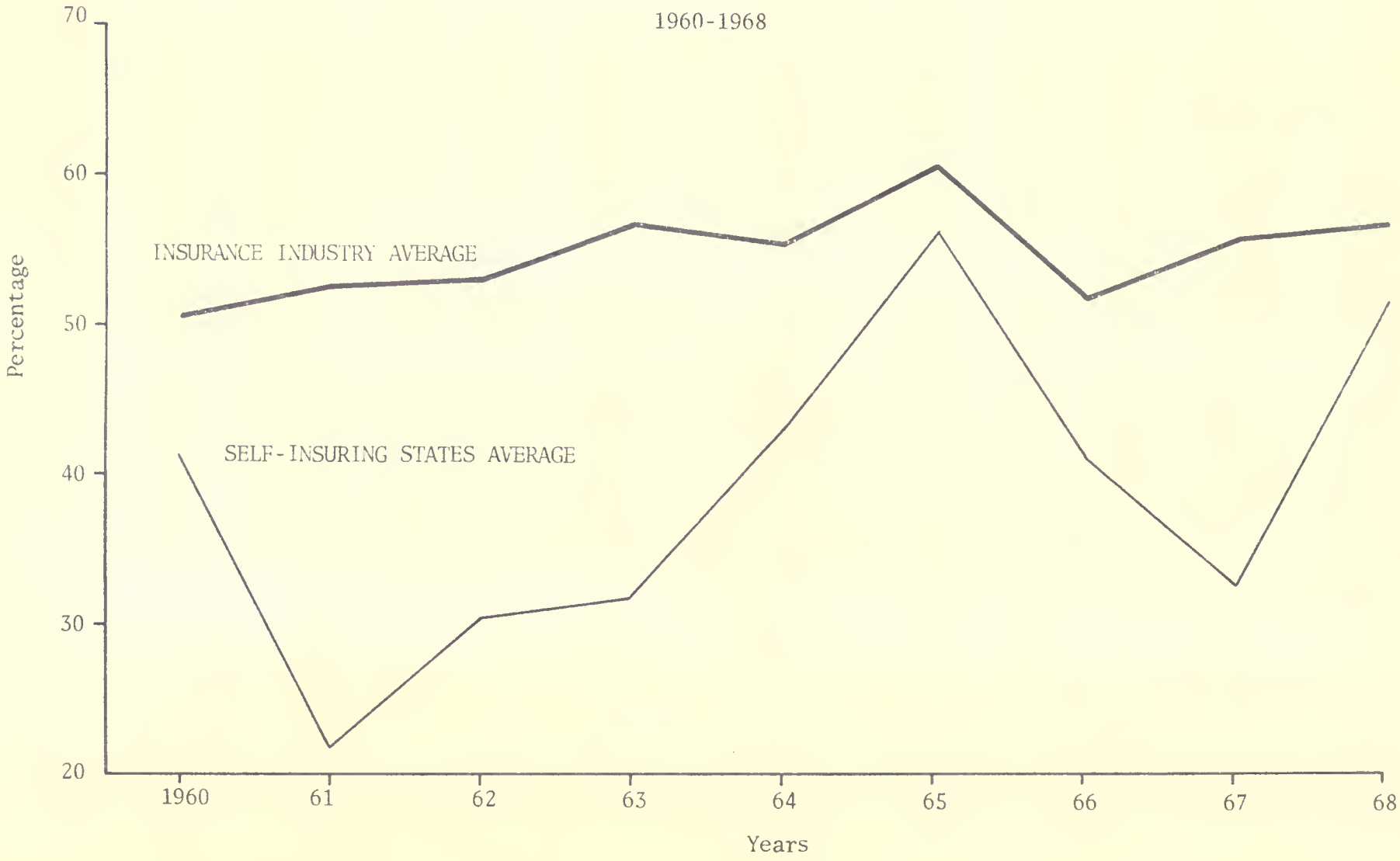
Year	Total Property Value ($000,000)	Fund Assets ($000)	Loss Ratio[b] (%)	Expense Ratio[c] (%)	Return on Avg. Assets (%)
1965	248	2,683	35.8	6.1	NA
1966	364	1,471	10.3	5.4	2.2
1967	435	1,803	26.0	4.8	4.8
1968	588	2,187	38.8	6.6	4.6

[k] Data are for calendar-year bienniums ending December 31.
[l] Data are for fiscal-year bienniums ending June 30. Data are not comparable with other states because of Oregon's statutory limitations on premium charges.
[m] Total Property Value less values insured commercially.
[n] Data are for fiscal year ending April 30.

CHART I

Average Losses as Percentage of Premiums
For Insurance Industry (Fire & Extended Coverage)
And Eight Self-Insurance States

1960-1968



includes only eight states, it is not surprising to find greater variability in the latter figures. Nevertheless, the self-insurance states have had enviable loss records during the last nine years. This is particularly noteworthy since premiums charged in at least four of these states are from 40-50 percent less than those of commercial companies or rating bureaus. Furthermore, there is no indication that loss ratios are rising in these states. The same is true of expenses as a percentage of premiums; no state has ever had an expense ratio as high as the 49.3 percent average for property-casualty companies in 1968. Although adding the cost of reinsurance raises the total cost -- in some states by another 20 percentage points -- operating efficiencies are still significant when compared to those of commercial companies.

Combining losses and expenses as is done in Table III reveals that there are only four cases in which more than 100 percent of premiums were expended for losses and expenses. Three of the four observations occurred within one state. Earlier in this report, the possible savings from self-insurance were estimated at 26.0 percent of total premiums. That means that losses and expenses should average about 74.0 (100.0 - 26.0 = 74.0) percent of premiums. Chart II illustrates that the self-insuring states have always done better than was estimated. This suggests that the savings estimate provided earlier is realistic and can be achieved in practice.

In summary, the programs in these nine states comply with the criteria of self-insurance, including the establishment of a reserve fund for losses, maximum risk levels, management services and catastrophe coverage. Operated on these bases, the programs seem to be efficiently managed; there is no evidence suggesting mismanagement, misappropriation or inadequate coverage. Furthermore, the loss and expense ratios are generally below the industry averages. Even if these ratios should rise to industry levels, the investment income earned by the fund would still provide a net return to the states. This income probably exceeds the premium tax foregone in each state although it would be difficult to measure exactly.

TABLE III

Losses and Expenses
As a Percentage of Premiums
Eight Self-Insuring States
1960-1969

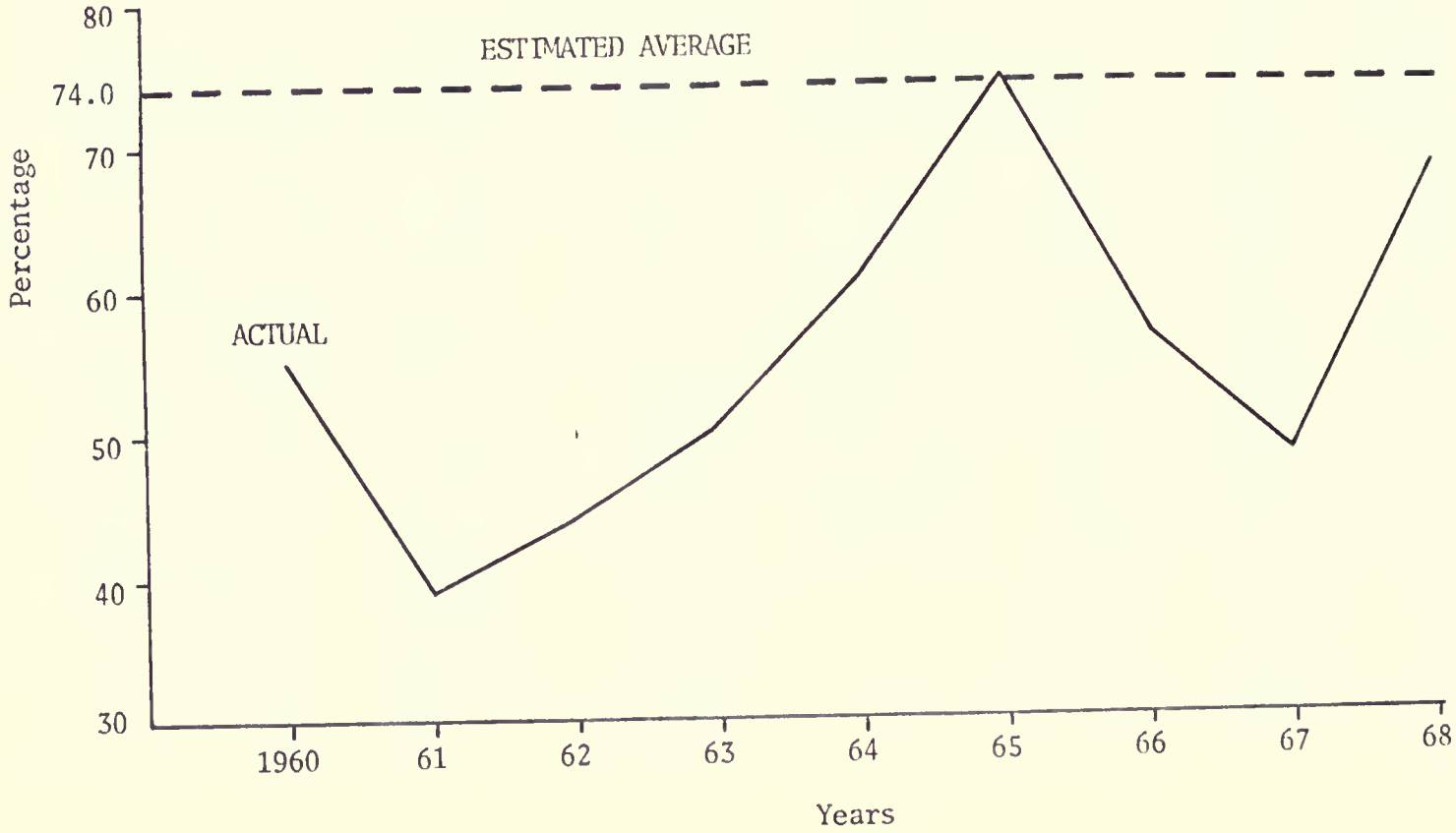
Year	Alabama	Florida	Georgia	Kentucky[a]	North Carolina[b]	North Dakota[b]	South Carolina[b]	Wisconsin
1960	55.1	NA*	NA	NA	NA	64.2	58.0	42.7
1961	40.0	NA	NA	36.5	41.3	NA	43.6	32.3
1962	55.1	17.1	NA	32.4	34.0	46.3	50.0	73.9
1963	22.3	21.0	NA	56.8	92.2	NA	30.5	78.3
1964	62.2	44.3	NA	59.8	57.6	51.2	46.6	100.9
1965	33.6	70.5	41.9	47.3	93.5	NA	67.0	168.2
1966	70.6	45.4	15.7	58.4	96.2	34.2	75.1	61.3
1967	37.9	20.5	30.8	40.2	57.4	NA	67.7	83.0
1968	74.1	22.2	45.4	15.0	81.0	130.3	70.1	107.9
1969	NA	NA	NA	67.1	98.1	NA	NA	NA

Note: States have differing fiscal or calendar-year ending dates.
*NA denotes not available.
[a] Cost of reinsurance included for 1963-1967.
[b] Cost of reinsurance included.

CHART II

Losses and Expenses as Percentage of Premiums
Eight Self-Insuring States

1960-1968



CHAPTER IV

MONTANA'S INSURANCE PROGRAM -- PAST AND PRESENT

Early Developments

The question of insurance on state property was first considered in 1893, when the legislative assembly appropriated $400.00 to insure state property, $360.00 of which was set aside for insuring the state law library. However, it was not until 1897 that licensing laws were enacted in Montana. An insurance commissioner was not appointed until 1909.

Prior to 1932 commercial insurance carried on public buildings was handled by a group of insurance companies, commonly known as a pool, and the commissions from the state were distributed to the various participating agents. In 1933, when the total value of state property was set at $9,300,000, the state reverted to a bidding basis; the lowest bidder received the entire line of insurance.

During the 1923-33 decade, over $300,000 was expended for insurance premiums; during the same period total losses were between $8,000 and $9,000; thus, for every $37.00 in premiums, the state collected $1.00 in insurance claims. It was under these circumstances that the 1935 legislature, after heated discussions, passed a law providing for the self-insurance of state-owned properties. More specifically, the law stated:

> That all public buildings of this state and of each and every political subdivision thereof, and the contents of all such buildings, except as hereinafter provided, shall be insured by the state against all direct loss by fire, lightning, tornado, windstorm, cyclone, hail, explosion, flood and water damage, under the provisions of this Act, which said insurance shall be provided for, determined and paid for as provided by this Act.

Despite passage in the legislature, the Act was defeated by a large majority when it appeared on the ballot as a referendum in November, 1936. Although one could speculate at great lengths about the reasons for failure, the limited information allows only that -- speculation. One explanation may be that the Act was poorly written, and secondly, that there seemed to be a lack of competent and conscientious administration.

The Current Insurance Program

Since 1936 the state has purchased commercial coverage for state-owned buildings and their contents. Currently, coverage is purchased for three-year periods, with the present contract expiring on July 1, 1971. Despite the three-year term, premiums are paid annually. All buildings and their contents are insured against fire and extended coverage, the latter classification including windstorm, hail, explosion, riot, riot attending a strike, civil commotion, and aircraft, vehicle and smoke damage.

All insurance contracts are negotiated with representatives of the mutual and stock company associations, the amount of insurance written by each being determined by the proportion of the total premium tax paid to the state by their respective member companies. On that basis the stock company association (Montana Association of Insurance Agents) writes 90 percent of the business and mutual group (Montana Association of Mutual Agents) the remaining 10 percent; the actual contracts are presently written by the Home Insurance Company and the Northwestern Mutual Insurance Company (Uniguard) respectively. Home and Uniguard reinsure with associate insurance companies, similarly, on the basis of premium tax paid in Montana.

State buildings and their contents are insured under one of three forms

attached to the standard fire contract: (1) the Public and Institutional Property (PIP) form which insures all eligible property; (2) the Miscellaneous Blanket form which insures property ineligible for the PIP form; and (3) a specific insurance coverage on property acquired by the Right-of-Way Division of the Highway Commission during condemnation proceedings. The 90 percent coinsurance clause applies to all values insured except those under the Right-of-Way form.

Montana adapted its insurance coverage to the PIP form on July 1, 1960, and approximately 95 percent of all insurable values are presently covered under this form. The PIP form is available to public institutions which meet specific underwriting requirements, the most important of which is compliance with an inspection program.

The Miscellaneous Blanket form covers approximately 5 percent of the state's insurable values ($8 million). Property ineligible for PIP, including the state prison, Mountain View School, Pine Hills School, Swan River Youth Forest Camp and several airport facilities are insured on this form.

A third classification of coverage is written to cover right-of-way property. Values involved are about $71,000, or about 1/20 of 1 percent of the total. However, there is a provision made for the automatic inclusion of all properties acquired by the Highway Commission during condemnation proceedings.

These contracts are generally written without the use of deductibles but some policies currently carry deductible clauses which vary in amount in accordance with: (1) location of the property; (2) kind of property covered; and (3) the nature of possible perils. In general, $100 is deducted from every loss arising from all insured perils other than fire and lightning and for all values insured under the PIP form with a limit of an aggregate deductible of $1,000 on any one occurrence. A $50 deductible is applicable to fire and lightning loss to dwellings covered under this form. A $50 deductible is also applicable to losses to dwellings which are insured under the Miscellaneous Blanket and the Right-of-Way forms. This last deductible is increased to $100 for losses originating from wind and hail for state property in 31 counties -- those counties east of a line drawn north and south through Great Falls.

Valuations for state properties are constantly changing as repairs, additions, alterations, acquisitions and disposals are made. The form of these contracts anticipates these changes by calling for periodic inspections and adjustment of insurance coverage. One state agency, the Board of Examiners, has the responsibility for administering all state insurance matters; however, several other groups offer inspection services. Each individual agency, department head, or administrator must complete a "self-inspection blank" semiannually to qualify for the PIP plan. The Montana Fire Rating Bureau inspects state properties annually and the Montana Association of Insurance Agents conducts a thorough reappraisal of values every three years. Furthermore, the Montana Fire Marshal's Office is continuously inspecting buildings throughout the state with specific attention given to fire prevention recommendations.

Property Valuations and Geographic Distribution

As of January 6, 1970, the total value of state buildings and their contents totaled $176 million; these valuations are located at 177 places around the state and single valuations (locations) range from $1,111 to over $42 million.

Over 77 percent (137) of the total number of properties are valued at less than $50,000 and only fifteen locations carry valuations greater than $1 million (Table IV). The large number of locations suggests that state-owned properties are widely distributed around the state. However, considering the several very large concentrations, these numbers are deceptive. In terms of value, the fifteen locations with valuations over $1 million together account for over 95 percent of the total value and two locations, Bozeman and Missoula,

TABLE IV

Number, Valuation, and Percentage Distribution
of State-Owned Properties

January 6, 1970

Valuation[a]	Number of Properties	Total Value Within Category ($000)	Percentage of Total Value
Less than $10,000	52	328	.18
$10,000 - $49,999	85	1,860	1.05
$50,000 - $99,999	10	816	.46
$100,000 - $299,999	9	1,477	.84
$300,000 - $999,999	6	3,252	1.84
$1,000,000 - $2,999,999	4	7,803	4.42
$3,000,000 - $5,999,999	3	16,068	9.11
$6,000,000 - $9,999,999	3	20,367	11.54
$10,000,000 - $29,999,999	3	43,152	24.46
Over $30,000,000	2	81,325	46.09
	177	$176,449	99.99

Note: Figures may not add due to rounding.

[a] Total values were calculated by the author from the 90 percent insurable values reported by the State Board of Examiners. Each property represents a location. In some cases location totals are distorted because "all contents" belonging to one agency are listed at one location; when, in fact, the contents are at several locations.

represent 46 percent of the total. Furthermore, ten of the fifteen locations, with a combined valuation of about $140 million, are located within a 100 air-mile radius of Anaconda (Map I).

For the purposes of assessing a commercial as opposed to a self-insurance program, the significance of these valuations and their geographical concentration depends, in large part, on the actual type of program being considered. For example, the concentration of properties has more significance when talking about earthquake as opposed to, say, fire coverage.

Premium and Loss Record

From July 1, 1951 to December 31, 1968, Montana paid approximately $3 million in insurance premiums. During that same period, losses totaled $1,330,451, and yearly loss ratios (losses as a percentage of premiums) ranged from 6.0 percent in 1960 to 133.9 percent in 1963 (Table V). For a more recent period, 1957-1968, losses totaled $1,052,720 while premiums were more than double that amount at $2,490,660; in seven of those years the ratio of losses to premiums was under 30 percent. Looking at the total period again, there were only two years out of eighteen in which the state collected more than it paid out in premiums. If one considers the three-year contract periods, premiums have always exceeded losses recovered (Chart III).

Although these figures demonstrate that Montana has been paying considerably more in premiums than it has collected in loss payments, caution should be used in interpreting the yearly loss ratios: premiums are paid on a three-year fiscal basis and the yearly premiums were derived by simply averaging the total payment over three years and then shifting to a calendar-year basis; since property values are rising continually, premiums were probably not as evenly distributed over these three-year periods as is indicated by an average. It should also be noted that occasionally premium changes resulted from policy changes rather than changes in risks or property valuations -- the most important change being the policy cancellation in fiscal period 1960-62 which enabled the state to place all eligible property under the Public Institutional Property form.

Despite these statistical complications, the loss ratios are most revealing. It matters little what statistical techniques are applied to these yearly figures or over what periods they are averaged. The results are the same: there has been substantial variation in Montana's loss experience. Furthermore, there is no obvious pattern of declining variability. These extreme variations indicate that it would be virtually impossible to accurately predict future losses.

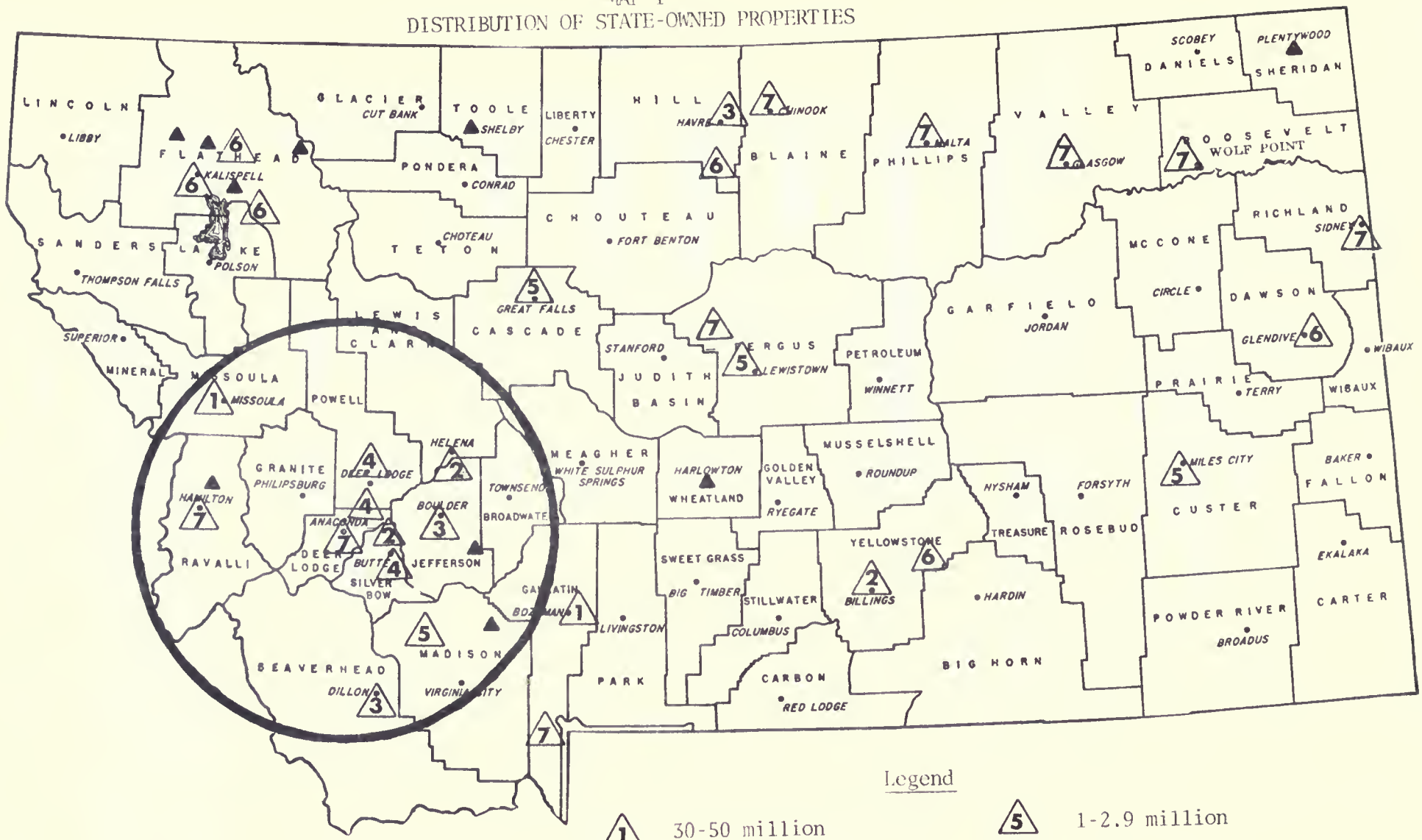
Frequency and Severity of Losses

Of the 359 losses occurring between July 1, 1951 and December 31, 1968, 162 or over 45 percent were caused by fire. Wind or windstorm was the next most frequent cause accounting for 110 or 30.6 percent of the total (Table VI). Hail, explosion and lightning caused 15.1, 2.6, and 1.7 percent of the losses respectively, while smoke, riot and vehicle damage each accounted for about one percent of the total. In contrast to total losses, the number of losses occurring each year has stabilized considerably, particularly in the last four years.

Losses to state property typically resulted in very small claims. As illustrated in Table VII, about 57 percent of the total number of losses reported during the eighteen-year period resulted in claims of less than $500.00. The next highest frequency occurred within the $1,000 - $4,999 range, representing 21 percent of the total. Only four losses were in excess of $50,000. Quite a different pattern emerges with a review of the loss severity figures (Table VIII). Over 37 percent of the total dollar loss resulted from the four losses whose individual values exceeded $50,000, and only 2.6 percent of the total

MAP I

DISTRIBUTION OF STATE-OWNED PROPERTIES



Legend

1	30-50 million
2	10-20 million
3	6-9.9 million
4	3-5.9 million
5	1-2.9 million
6	300-999 thousand
7	100-299 thousand
▲	50-99 thousand

Note: Valuations represent insurable values.

TABLE V

Premiums, Losses, and Loss Ratio[a]
State of Montana

July 1, 1951 to December 31, 1968

Year		Premiums Paid[b] ($)	Total Losses[c] ($)	Loss Ratio (Losses/Premiums) (%)
1951	(July - December)	39,884	9,126	22.9
1952		79,768	95,517	119.7
1953		79,768	6,389	8.0
1954		98,138	87,959	89.6
1955		116,509	66,557	57.1
1956		116,509	12,184	10.4
1957		130,730	14,288	10.9
1958		144,953	72,353	49.9
1959		144,953	109,102	75.3
1960		193,730	11,723	6.0
1961		242,509	68,836	28.4
1962		226,722	134,231	59.2
1963		210,937	282,541	133.9
1964		210,937	26,492	12.6
1965		231,142	175,257	75.8
1966		251,349	70,781	28.2
1967		251,349	38,321	15.2
1968		251,349[d]	48,795	19.4
	Total	$3,021,236	$1,330,452	

[a] Losses represent the amount claimed as opposed to the amount actually paid by the insurance company, and the date of loss, rather than the date of payment, was used in determining the year in which the loss occurred.
[b] Yearly premium payments were derived by averaging fiscal-year payments over a three-year period and then shifting the basis to a calendar year.
[c] Losses not covered by state policies are excluded from these figures.
[d] Estimated.

CHART III

State of Montana
Premiums Paid & Losses Recovered
Fiscal Periods, 1942 to 1968

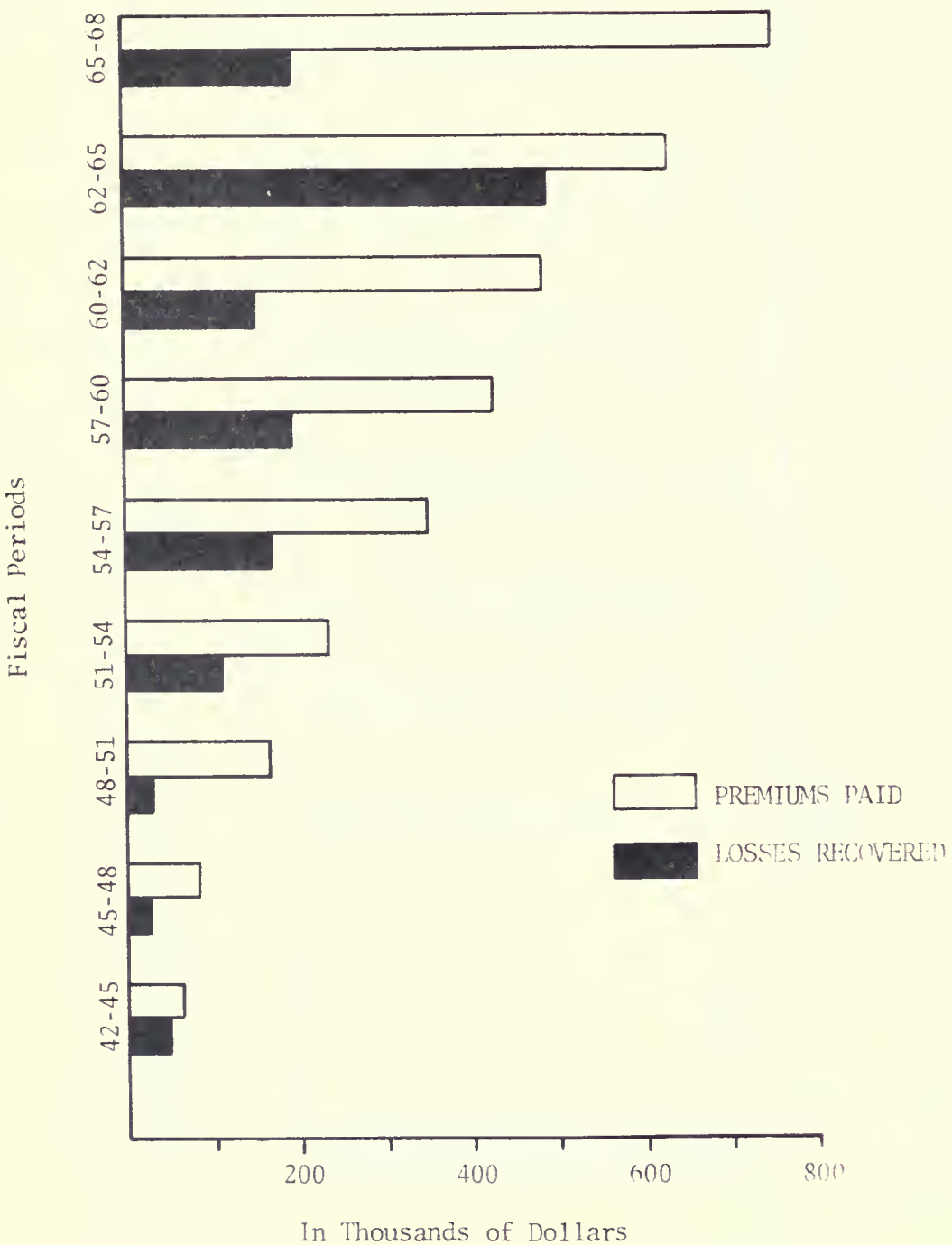


TABLE VI

Number of Losses on State-Owned Properties
by Type of Loss

1951-1968

Year of Loss	Total Number of Losses[a]	Fire	Wind or Windstorm	Hail	Explosion	Lightning	Smoke	Riot	Vehicle	All Other[b]
1951 (July -	7	4	2	--	1	--	--	--	--	--
1952 December)	18	11	3	1	2	--	--	--	--	1
1953	13	7	5	1	--	--	--	--	--	--
1954	14	10.5	1	1	--	0.5	--	--	--	1
1955	21	5	5.5	7	1	--	1	--	--	1.5
1956	21	12	8.5	--	--	0.5	--	--	--	--
1957	15	9	4	1	--	--	--	1	--	--
1958	24	2	10.5	8	1	1	--	--	1	0.5
1959	27	6.5	13.5	1.5	1.5	--	--	1	1	2
1960	14	4	8	1	1	--	--	--	--	--
1961	39	17	11	11	--	--	--	--	--	--
1962	38	8	16	11	--	1	1	--	--	1
1963	22	14	2	3	--	2	1	--	--	--
1964	8	4	2	1	--	--	--	1	--	--
1965	17	6	5	5	--	1	--	--	--	--
1966	18	12	3	2	--	--	--	--	1	--
1967	20	16	4	--	--	--	--	--	--	--
1968	23	14	6	--	2	--	1	--	--	--
Total Number	359	162	110	54.5	9.5	6	4	3	3	7

[a] Losses not covered by the policies are excluded from these figures.
[b] Includes losses caused by vandalism, glass breakage, damage by water, fire and smoke, and those losses reported without the cause being listed.

TABLE VII

Number of Losses on State-Owned Properties
by Size of Loss

1951-1968

Year of Loss	Total Number of Losses[a]	Under $500	$500-$999	$1,000-$4,999	$5,000-$9,999	$10,000-$19,999	$20,000-$49,999	$50,000 and Over
1951 (July - December)	7	4	2	--	1	--	--	--
1952	18	12	--	4	--	--	2	--
1953	13	10	--	3	--	--	--	--
1954	14	7	2	4	--	--	--	1
1955	21	12	3	2	1	2	1	--
1956	21	17	1	3	--	--	--	--
1957	15	9	2	3	1	--	--	--
1958	24	11	2	7	2	1	1	--
1959	27	20	3	2	--	1	--	1
1960	14	10	1	3	--	--	--	--
1961	39	26	2	7	2	1	1	--
1962	38	21	4	8	1	2	2	--
1963	22	11	2	6	1	1	--	1
1964	8	2	1	4	--	1	--	--
1965	17	7	--	5	--	2	2	1
1966	18	4	4	7	1	1	1	--
1967	20	12	4	3	--	--	1	--
1968	23	9	5	6	2	1	--	--
Total Number	359	204	38	77	12	13	11	4

[a] Losses not covered by the policies are excluded from these figures.

TABLE VIII

Amount of Losses on State-Owned Properties
by Size of Loss

1951-1968

Year of Loss	Total Loss[a]	Under $500	$500-$999	$1,000-$4,999	$5,000-$9,999	$10,000-$19,999	$20,000-$49,999	$50,000 and Over
1951 (July-December)	9,126	532	1,948	--	6,646	--	--	--
1952	95,517	2,308	--	7,055	--	--	86,154	--
1953	6,389	1,146	--	5,243	--	--	--	--
1954	87,959	978	1,021	5,960	--	--	--	80,000
1955	66,557	1,610	2,130	7,190	6,113	24,489	25,026	--
1956	12,184	3,987	906	7,290	--	--	--	--
1957	14,288	2,129	1,363	4,797	6,000	--	--	--
1958	72,353	909	1,734	17,389	15,285	12,877	24,159	--
1959	109,102	2,580	2,031	2,369	--	12,099	--	90,022
1960	11,722	930	684	10,108	--	--	--	--
1961	68,836	3,615	1,138	15,391	15,534	12,154	21,003	--
1962	134,230	4,459	3,008	18,585	7,714	32,290	68,175	--
1963	282,541	1,928	1,272	12,364	6,592	18,940	--	241,444
1964	26,492	372	690	7,575	--	17,854	--	--
1965	175,257	1,967	--	13,990	--	29,620	43,451	86,228
1966	70,781	913	3,545	18,884	5,491	12,198	29,750	--
1967	38,321	2,669	2,797	7,129	--	--	25,727	--
1968	48,796	2,218	3,014	13,922	13,011	16,630	--	--
Total	$1,330,451	$35,251	$27,280	$175,242	$82,386	$189,153	$323,445	$497,694
Percentage Distribution	100	2.6	2.0	13.2	6.2	14.2	24.3	37.4

Note: Totals may not add due to rounding. Dash (--) denotes zero.
[a] Losses represent the amount claimed rather than the amount actually paid by the insurance company.

resulted from claims which individually amounted to less than $500. Thus, even though the number of serious losses was relatively few, their combined value accounted for a significant portion of the total property value lost during the period.

Financial Capacity

The financial "capacity" of a political unit is difficult to define, let alone measure. And a comprehensive attempt to do either is beyond the scope of this report. Yet, it is necessary to determine the extent to which Montana could meet the financial requirements of a self-insurance program. Within that context, there are two major financial requirements: flexibility of debt financing (or "slack" in the capital expenditure program) and adequate cash or near-cash reserves. The debt financing requirement provides added assurance against the loss of facilities for extended periods. For example, losses may occur which exceed "projected losses" but which fall short of utilizing the commercial coverage for catastrophes; if these combined losses are greater than current reserves, the state may have to borrow money for rebuilding -- a not-too-uncommon situation for a newly-initiated program.

Although per capita debt levels are comparatively low in Montana, there is little flexibility in debt financing. In order to borrow additional funds, debt proposals must be (a) enacted by the legislature and (b) approved by a popular referendum. These requirements, combined with biennial legislative sessions and a fully-committed capital expenditure program, would make it very difficult to finance above-normal losses through debt financing. In this regard, the prevailing interest rate structure would place an additional burden on the state. It should be pointed out, however, that four of the states currently operating self-insurance programs have exactly the same limitations on debt financing and the five other states have even less flexibility -- the constitution prohibits state borrowing except as authorized by a constitutional amendment.

Adequate cash or near-cash reserves are not nearly as dependent upon existing statutes as a debt financing. That is, the self-insurance law can be structured to provide the latitude and administrative mechanism for an accumulation of insurance reserves. Also, the law can be written to preclude the diversion of insurance reserves to other projects. As a practical matter, if the loss experience is reasonably predictable, there should be very little legislative opposition to an appropriation for self-insurance or to the administrative guidelines which will maintain adequate reserves. This presumes, of course, that the combined cost of self-insurance and catastrophe protection would not be substantially greater than the projected cost of the current insurance program.

From a legislative standpoint, the cost of self-insurance could be placed entirely in the budget of the administering agency or in individual agency budgets -- prorated on the basis of insurable values. (However, there would probably be more interest in self-insurance if each agency were charged for its own coverage.) Other administrative procedures which ultimately affect the adequacy of insurance reserves include: (1) centralization of the administrative responsibilities; (2) the basis for setting premiums; (3) loss and claim procedures; (4) the accounting system; (5) investment guidelines; and (6) loss prevention measures. The administrative facets of self-insurance programs discussed in Chapter III could be used to develop the specific procedures.

Montana's Insurance Program -- A Critique

Many aspects of Montana's insurance program have been discussed in the preceding pages, along with other statistical data which pertain to the issue of self-insurance. Although the primary purpose of this report is to examine this information only insofar as it relates to self-insurance, several aspects

of the current program deserve further comment. First, regardless of whether or not a self-insurance program is considered feasible, the legislature or a qualified state official should continually reevaluate the insurance program. Currently there are no specific provisions requiring a periodic legislative review.

The state has apparently never seriously considered the use of large deductibles as a way to lower insurance costs. The largest aggregate deductible under the current program is $1,000 (under the PIP form). Assuming no changes in the type of coverage or the contracting firm, utilization of a per-occurrence deductible would have provided substantial savings to the state. As Table IX illustrates, the state would have saved about $364,000 during the 1951-1968 period with a $1,000 deductible. Lesser amounts would have accrued with $5,000, $10,000 or $25,000 deductibles; even a $50,000 deductible would have saved the state almost $25,000 over the period (Chart IV). As indicative of savings as these figures are, they are understated: yearly premiums are higher now than in earlier periods so the yearly savings figure is constantly increasing -- a fact that is not evident when considering the entire period. Further, whenever an insurance contract is as large as that of the state line, deductible credits would normally be negotiated. The negotiated credits could be higher than the 18, 22, 25, 31 and 35 percent used to demonstrate the potential savings. Perhaps periodic legislative reviews or the use of some type of competitive system would have initiated the use of deductibles long before now.

The absence of certain coverages, especially earthquake, vandalism and malicious mischief is disconcerting. It may be uneconomical to insure these perils. Yet, the decision should be a conscious one and there is no evidence to indicate that the state has actually evaluated the possible alternatives. Certainly, earthquake coverage, for example, would be too costly unless purchased with a very large deductible. As a final note, the state continues to insure all properties -- even a $100 garbage shed at Warm Springs. The loss adjustment expense is typically very high per dollar of value whenever such insignificant values are insured.

This by no means represents a complete appraisal of the current insurance program; that was not the purpose of this report. However, these deficiencies suggest that there should be a complete reevaluation of the state's insurance coverage and the mechanism through which it is provided.

TABLE IX

Estimated Savings from Various Deductibles
Montana

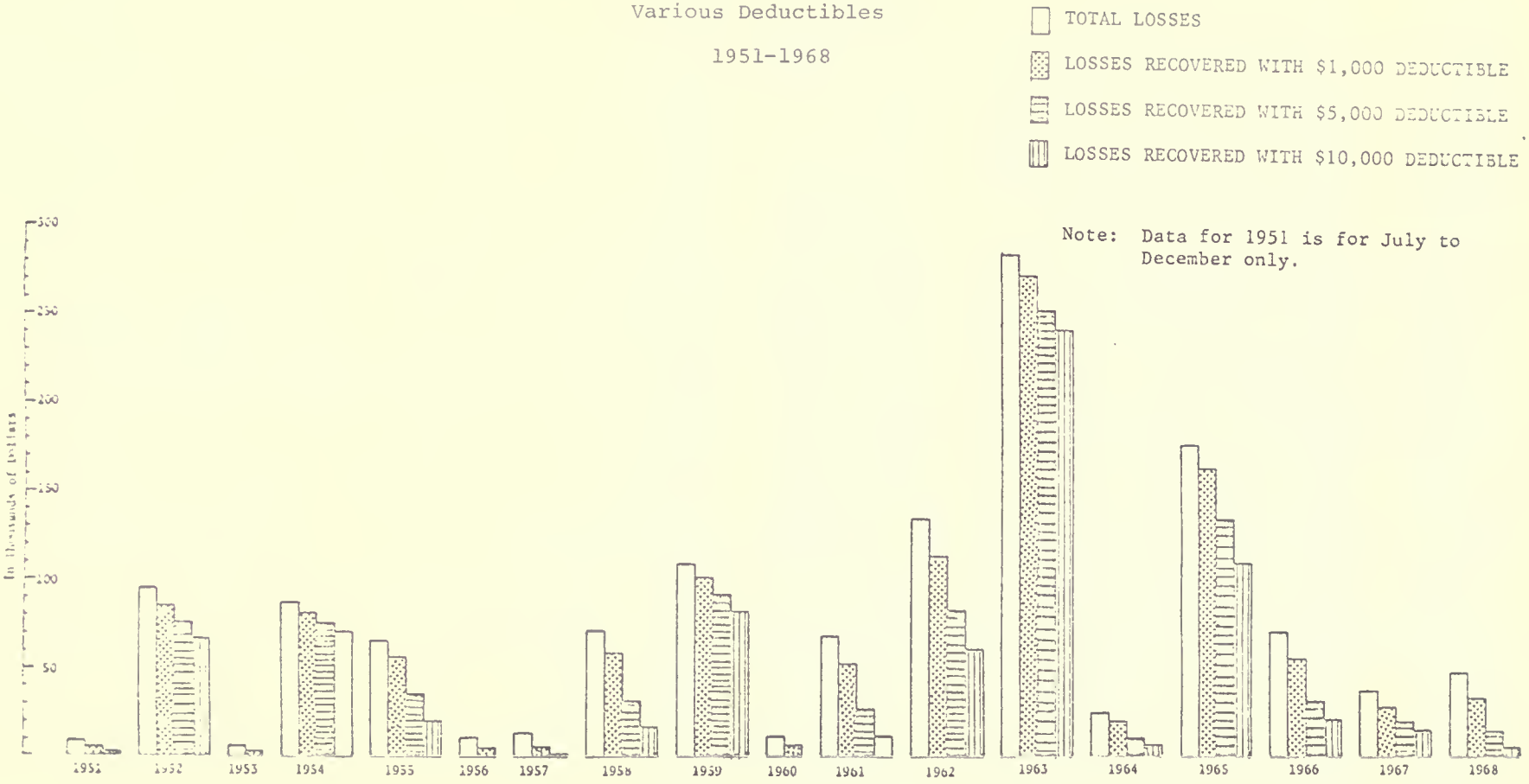
July 1, 1951 to December 31, 1968

	Deductible Per Occurrence				
	$1,000	$5,000	$10,000	$25,000	$50,000
Total Premiums	$3,021,236	$3,021,236	$3,021,236	$3,021,236	$3,021,236
Deductible Credit	18%	22%	25%	31%	35%
Gross Savings (credit times premium)	$ 543,822	$ 664,672	$ 755,309	$ 936,583	$1,057,433
Less Deductible Losses Paid by State	179,531	437,773	600,159	784,315	1,032,757
Estimated Net Savings	$ 364,291	$ 226,899	$ 155,150	$ 152,268	$ 24,676

CHART IV

State of Montana
Total Losses Incurred
and Losses Recovered With
Various Deductibles

1951-1968



CHAPTER V

CONCLUSIONS AND RECOMMENDATIONS

The Council concludes that no new state agency or board should be created to handle the administration of the state's insurance program and recommends that the program be handled in an existing state agency.

The Council is concerned by the fact that Montana does not carry insurance for losses by earthquake on state-owned buildings and properties. Recognizing that the extremely high cost of this type of insurance makes it prohibitive for the state to have this protection through commercial sources, the Council recommends the establishment of a fund for losses by earthquake. This fund will not be expected to offset major disasters caused by earthquakes, but would help in the loss of a single building, etc. No amount will be stipulated as to the amount to be funded for this purpose each session. The Council recommends that the limits be established by the Legislative Assembly.

It is the conclusion of the Council that a deductible-type insurance program for the state would result in a possible savings and therefore recommends that a deductible-type insurance program be established, the amount of the deductibles to be determined by the legislature or the administrative agency.

A P P E N D I C E S

APPENDIX A

_____ BILL NO. _____

INTRODUCED BY _____

A BILL FOR AN ACT ENTITLED: AN ACT TO PROVIDE A DEDUCTIBLE PLAN OF INSURANCE FOR STATE BUILDINGS AND THEIR CONTENTS.

BE IT ENACTED BY THE LEGISLATIVE ASSEMBLY OF THE STATE OF MONTANA:

Section 1. A deductible plan of insurance shall be established for use by the state in insuring state buildings and their contents.

Section 2. The administration of this act shall be placed in the department of administration with the cooperation of the insurance commissioner.

APPENDIX B

_____ BILL NO. _____

INTRODUCED BY _____

A BILL FOR AN ACT ENTITLED: AN ACT TO PROVIDE FOR A STATE EARTHQUAKE INSURANCE FUND FOR PUBLIC BUILDINGS AND THE CONTENTS THEREIN.

BE IT ENACTED BY THE LEGISLATIVE ASSEMBLY OF THE STATE OF MONTANA:

Section 1. $_____ is appropriated from the general fund for the establishment of a fund to be known as the state earthquake insurance fund.

Section 2. Property insurable in this fund shall be restricted to state buildings and their contents.

Section 3. The department of administration is hereby designated as the agency through which this fund shall be administered, and the director of said agency is empowered with such authority as may be necessary to carry out its purpose.